

**BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001**

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Postal Rate and Fee Changes, 2000

Docket No. R2000-1
POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

**INITIAL BRIEF OF THE
NEWSPAPER ASSOCIATION OF AMERICA**

September 13, 2000

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The Newspaper Association of America ("NAA"), by its attorneys, hereby respectfully submits its initial brief in this proceeding.¹

I. INTRODUCTION AND SUMMARY

A. Overview

The members of the Newspaper Association of America strongly believe that the Postal Service, a part of the federal government, should focus on its public service mission of providing universal service at equitable, non-discriminatory rates.² In keeping with this public service mission, newspapers believe that the Postal Service should not take actions that favor certain mailers over the press or that align the interests of the Postal Service with those of the press' competitors.

As the testimony of NAA rebuttal witness William Wilson explains, the revenues from newspapers' advertising literally pays for the newspapers' editorial content, which

¹ The Trial Brief of the Newspaper Association of America (June 29, 2000) is an integral part of this brief. NAA is also joining with the Association of Alternate Postal Systems in a separate brief under seal concerning the SAI Report.

² Newspapers are one of the few industries that receive the vast majority of their revenue through First Class mail. Newspapers rely on Periodicals and Standard A Enhanced Carrier Route ("ECR") mail for the delivery of their editorial and advertising products.

enables the American public to receive news and other editorial information at a very modest price. From the largest national daily to the hundreds of suburban newspapers throughout our nation, run-of-press ("ROP") and preprint advertising allow newspapers to operate as the Fourth Estate, and serve as a watchdog over all levels of government.

NAA's primary interest in this proceeding is in the rates to be recommended for Standard (A) ECR mail -- in particular, the rates for saturation mail and, specifically, heavier "above breakpoint" mail. Saturation mailers compete directly with newspapers' ROP and preprint advertising.³ Saturation mailers do not distribute any significant degree of editorial information, and thus do not use their advertising revenues to cross-subsidize the gathering and distribution of editorial information. This is in sharp contrast to newspapers, whose advertising revenues pay for the collection, editing, publishing and distribution of editorial content.

Newspapers offer zip-code specific and saturation coverage to those advertisers that desire it through Total Market Coverage ("TMC") programs, most of which are distributed via mail. This activity usually places newspapers in the position of being one of the largest customers of the Postal Service in the locality in which the newspaper is published. This continues a relationship that has existed since Colonial times, when

³ The record is abundantly clear that daily newspapers such as the *Miami Herald* and others compete directly and vigorously with saturation mailers such as Advo, Harte-Hanks, witness Baro's *The Flyer*, and witness Bradpiece's *Pennysaver* for the inclusion of advertising matter in their products, and charge comparable rates. See Tr. 44/19154-59 (Wilson). Newspapers and other direct mailers also compete with television, cable, Internet and radio. See Tr. 44/19154-59 (Wilson); Tr. 44/18918, 18930 (Bradpiece). Newspapers offer targeted and saturation coverage to those advertisers that desire it through their Total Market Coverage ("TMC") programs.

one of the leading newspaper publishers of the times, Benjamin Franklin, was named the first Postmaster General.

Both newspapers and the shared mailers with which they compete essentially “resell” USPS wholesale delivery “services” (as well as add additional value) at retail prices.⁴ However, since part of a newspapers’ distribution is not through the mail,⁵ any effort by the Postal Service to lower ECR rates places newspapers at a significant competitive disadvantage. Thus, although newspapers do not compete with ECR mail head to head, newspapers are negatively affected by reductions in the Postal Service’s ECR rates. When newspapers lose advertising to its competitors, they publish less editorial content. When the Postal Service takes actions that favor those competitors, in order to shift business to them from newspapers, the Postal Service poses a direct threat to the financial support for newspaper editorial content.

Matters are not improved when the Postal Service makes statements that indicate that it views newspapers as competitors rather than valued customers. Such statements suggest that the Postal Service is not, in fact, neutral, but aligns its self-interest with newspaper competitors. Such statements are fundamentally inconsistent with the Postal Service’s public service mission, as well as with its Constitutional responsibilities.

⁴ On this point, NAA witness Wilson (Tr. 44/10134-61) and SMC witness Guiliano (Tr. 44/18995-19071) are in general agreement. The Postal Service acknowledges that newspaper TMC programs use postal delivery. See NAA/USPS-1(b-c).

⁵ For many years daily newspapers were distributed through the mail. In modern times, however, the necessity for very early a.m. delivery has precluded most daily newspapers from using the mail for distributing a significant portion of their circulation.

Directly at issue in this case is the proper role of the federal government *vis a vis* the press. While the press is not immune from any of the "ordinary forms of taxation" for support of the government, and obviously not immune from any sort of private sector competition, it is protected from deliberate attempts by the federal government to impair or reduce its advertising revenue under the First Amendment to the Constitution.

This means, *ipso facto*, that under the Constitution, the federal government (which here is the Postal Service) cannot try to drive revenue out of the pages of newspapers. This principle applies regardless of whether the government's attempt is successful. The principle can be traced back to the case of *Grosjean v. American Press Co.*, 297 U.S. 233 (1936) where the Supreme Court held a tax on the press unconstitutional because it sought to limit advertising revenue and thus restrict circulation.

Although in this case the Postal Service has backed away from admitting that its proposal to reduce key advertising rates is an attempt to shift advertising out of newspapers, it has more than admitted this in the past.⁶ This history squarely places the burden of proof on the Postal Service that its rate proposals are not, in fact, attempting to shift advertising from newspapers to direct mailers. The pattern of repeated proposed reductions in the ECR pound rate, unsupported by thorough and reliable evidence, should make this burden of proof almost insurmountable. This is

⁶ See Docket No. R97-1, USPS-T-36 at 26 (Moeller) (stating that because the ECR subclass "is in a competitive market and is susceptible to diversion to alternative media. . . . the rate structure should be sensitive to, and priced competitively with, the alternatives"). Indeed, a major rationale offered by the Postal Service for creation of the Enhanced Carrier Route subclass in Docket No. MC95-1 was a desire to be more "competitive" with private alternatives.

- Seize the opportunity presented by this case to fulfill the Commission's longtime desire to alleviate the disproportionate institutional cost burden on First Class mail, and ensure that Standard (A) ECR continues to make at least the same contribution to institutional costs, on a real, per-piece basis, as in Docket No. R97-1 and that the cost coverage or markup indices do not decline in absolute or relative terms;
- With respect to Periodicals rates, alleviate the disproportionate increases proposed by the Postal Service by crediting the cost reductions for reduced bundle breakage and the AFSM 100 correction proposed by MPA witness Cohen;
- In attributing city carrier costs:
 - Accept Mr. Raymond's Engineered Standards data as a desirable improvement to city carrier costs, and
 - Continue to attribute city carrier access and coverage-related load costs pursuant to the established single subclass stop costing methodology;
- Continue to assess the appropriate contribution to institutional costs on the basis of the Commission's measure of attributable costs, not the Postal Service's estimate of volume variable costs; and
- *IF* the Commission chooses to credit testimony that it should reduce the contingency factor to one percent (reducing the revenue requirement by about \$1.5 billion), the savings should flow to Periodical Mailers and First Class single-piece mailers (in the form of retention of the 33 cent stamp).

II. THE COMMISSION SHOULD INCREASE, NOT REDUCE, THE STANDARD (A) ENHANCED CARRIER ROUTE MAIL POUND RATE

This marks the second consecutive omnibus rate case in which the Postal Service has proposed to reduce the pound rate for Standard (A) commercial Enhanced Carrier Route mail. Here, while raising rates below the 3.3 ounce breakpoint, the Postal Service is proposing to reduce the ECR pound rate by up to 12.2 percent, with absolute rate reductions generally occurring at weights as light as four or five ounces. This decrease is occurring while the Postal Service is also proposing to raise already much higher First Class rates and seeks substantial hikes for Periodicals mail. As in Docket

No. R97-1, the Commission should reject the proposed ECR pound rate reduction as unsupported by reliable evidence, and in order to avoid drastic harm to the alternate delivery industry.

In Docket No. R97-1, the Commission established a high hurdle for any effort by the Postal Service to lower the competitively sensitive pound rate for ECR mail. The Commission stated that "rate reductions not firmly supported by reliable cost evidence that may jeopardize the visibility [sic] of small businesses, such as the alternative delivery services represented by AAPS, are not consistent with [39 U.S.C. §] 3622(b)(4)." *Opinion and Recommended Decision*, Docket No. R97-1 at 403, ¶ 5425 ("R97-1 Op."). Neither the Postal Service nor its supporters have met this burden.

Not only is there compelling evidence that lowering the rate would drastically injure the alternate delivery industry, but there is no credible evidence that such a reduction would actually benefit advertisers. Given the absence of any sound basis for reducing the pound rate, the Commission should correct for the decline in the real pound rate over the past few years by instead raising it in a manner consistent with an overall across-the-board increase in Standard (A) ECR rates.

A. The Alternate Delivery Industry Would Suffer Significant Harm From A Reduction In The Pound Rate

Although Section 3622(b)(4) of the Postal Reorganization Act specifically requires consideration of the effect of proposed rate changes on "enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters," the Postal Service apparently gave relatively little thought to this criterion. Indeed, it appears that the Postal Service systematically shields from its rate witnesses potentially

periodicals, leading to the practical abandonment of alternate delivery by magazine publishers." Tr. 22/9949. In Docket No. MC95-1, the alternate delivery industry testified that the proposed reclassification of second-class mail would cause great harm to their businesses. Bitter experience has proved them correct. The Commission should not allow the Postal Service to gloat in the future about the demise of yet another form of private competition.⁸

In Docket No. R97-1, the Postal Service candidly admitted that its proposal to reduce the pound rate was motivated by competitive concerns. Perhaps chastened by its experience in that case, the Postal Service has in this case disclaimed any competitive motivation. See Tr. 30/14695 (Tye). Given the history, this on its face is unpersuasive.⁹ Yet perhaps more profoundly troubling is the apparent utter lack of knowledge of, or even curiosity about, the alternate delivery industry by the Postal Service rate witnesses charged with designing rates that satisfy the law (including Section 3622(b)(4)).

In particular, neither witness Mayes (who assigns institutional costs) nor witness Moeller (who designs ECR rates) purport to have much knowledge of the alternate delivery industry. Neither Ms. Mayes nor Mr. Moeller reviewed the SAI studies before filing their testimony (nor did Postal Service rebuttal witness O'Hara). Tr. 11/4196

⁸ Former Postmaster General Runyon's public glee over the demise of Publishers Express is a matter of record in this proceeding. See Tr. 22/9949 (White).

⁹ As Mr. White notes, the Postal Service regularly commissions Strategic Analysis Inc. to study closely the alternate delivery industry. Indeed, SAI has called Mr. White himself twice *this year* as part of its ongoing investigation. Tr. 22/9947. NAA has joined AAPS in filing a separate brief under seal discussing the SAI Report.

(Mayes); Tr. 10/3834 (Moeller). Strikingly, the rate design witness admitted to having considered nothing beyond his sparse written testimony concerning the impact on alternate delivery companies. He admitted not having researched the industry, and not having reviewed the impact of the MC95-1 reclassification on alternate delivery. Tr. 10/4020 (Moeller). Section 3622(b)(4) certainly requires more than that.

Against this background, the Commission should not credit the testimony of SMC witness Buckel that hand delivery is "gaining an ever increasing portion of the distribution market for retail preprints." Tr. 22/9915. While it is no surprise that testimony sponsored by saturation mailers would favor lower saturation mail rates, Mr. Buckel's testimony is flawed for several reasons. First, Mr. Buckel has provided no evidence as to the actual numbers of preprints being distributed either by mail or by alternate delivery. Second, he has relatively little experience in alternate delivery. Third, his claim that "rising costs for saturation mail, combined with the artificially contrived, excessive pound rate, have tipped the teeter totter in favor hand delivery" (Tr. 22/9915) lacks credibility.¹⁰ The pound rate has not risen in years, and any other costs of saturation mail (such as paper) affect all modes of preprint distribution, not just mail.

NAA witness Wilson rebutted Mr. Buckel's testimony by describing the collapse of the alternate delivery industry since reclassification. Mr. Wilson, of Knight-Ridder, testified that, in the aftermath of the Docket No. MC95-1 reclassification, all but three of

¹⁰ Mr. Buckel's testimony discussed alternate delivery programs in only two markets. The testimony of Mr. Guiliano added four more, and of Mr. Bradpiece one. In contrast, Mr. Wilson's testimony noted that *just one company* (Knight-Ridder) had in recent years shut down alternate delivery programs in 25 markets. There are tens of other cities where this has happened, several of which are mentioned in Wilson's testimony.

his company's 28 alternate delivery programs ceased operations. Tr. 44/19142 (Wilson). He states: "Between 1996 and 1998, I assisted our newspaper-owned delivery companies as they converted from 90 percent hand-delivered non-subscriber programs to 80 percent postal delivery." *Id.*

Nothing in the rebuttal testimony of SMC witnesses Guiliano and Bradpiece provides a basis for a contrary conclusion. Mr. Bradpiece's alternate delivery company—which he just bought—was recently in bankruptcy. And while Mr. Guiliano attempts to portray Advo's handful of private delivery operations as indicative of an increasing departure from reliance on the mail, his testimony is undercut by the fact that neither Advo's most recent annual report nor its corporate Internet website make any mention of its alternate delivery operations.¹¹

Only in the rebuttal testimony of Dr. O'Hara did the Postal Service give lip service to Section 3622(b)(4). However, Dr. O'Hara's testimony appears confused as to whom the Postal Service is competing with. Much of his testimony seeks to compare postal rates to newspaper insert rates, although these are not comparable. Tr. 46E/21942-43 (O'Hara).

The evidence supports Mr. White. The Postal Service's proposed reduction in the pound rate would significantly harm what remains of the alternate delivery industry. Under Section 3622(b)(4), this counsels against recommending the proposed reduction.

¹¹ In any event, Advo's private delivery operations carry less than four percent of its total volume.

B. The Postal Service Has Failed To Justify Its Proposed Major Restructuring Of Standard (A) ECR Rates

As the proponent of reducing the pound rate, the Postal Service has the burden of proof. In this case, the Postal Service and self-interested direct mailers have based their arguments principally on a severely flawed Postal Service weight/cost distribution key analysis and their belief as to how costs must vary with weight. In addition, some intervenors have attempted to compare ECR pound rates with alleged private competitors, although the comparisons they make are inappropriate. These arguments fail to overcome the high hurdle that the Commission has set for such a competitively sensitive proposal.

1. The Postal Service has again ignored the Commission's repeated request for a comprehensive analysis of the effect of weight on costs

The Commission for years has asked the Postal Service to provide better evidence as to the effect of weight on costs of Standard mail. As the Commission has repeatedly observed, the Postal Service "has submitted the same basic cost study to the Commission since 1982, despite Commission requests for a more comprehensive analysis." *R97-1 Op.* at 402, ¶ 5423. The Commission should once again reject this approach as insufficient.

In Docket No. R97-1, the Commission was quite critical of the Postal Service's analysis of the effect of weight on costs for containing "no comprehensive study of cost-

causing factors.”¹² The Commission quoted favorably from NAA’s brief a critique of the Service’s weight-cost approach that applies equally in this case:

“ . . . the [cost-weight study] contains no attempt actually to observe or measure costs; nor is it [sic] a time/weight analysis. It does not arise from a comprehensive analysis of the cost-causative characteristics of Standard Mail A pieces of various weight of the type long requested by the Commission. Nor is it a simulation study or even an econometric regression analysis.”

R97-1 Op. at 401, ¶ 5421. As that decision went on to state, the Commission found: “the lack of a reliable cost-weight study to be singularly frustrating.” *R97-1 Op.* at 402 (citing past Commission requests). The recent joint Commission/Service Data Quality Study also called for “engineering studies that track weight in conjunction with other mail cost-causing characteristics through the entire production process.”¹³ No such study has occurred. NAA/USPS-10.

Although the Postal Service characterized the evidence sponsored by witness Daniel (USPS-T-36 at 20) as a “new cost study,” that evidence is simply another twist of the same approach that the Service has used since 1982 and that the Commission has consistently rejected.¹⁴ Indeed, witness Daniel herself declined to call her efforts a “cost study” – choosing instead the phrase “distribution key analysis.” Her distribution key analysis does not rectify the fundamental flaws in the approach that the Postal Service has been using for almost a decade.

¹² *R97-1 Op.* at 401, ¶ 5421.

¹³ Data Quality Study Summary Report at 93 (April 19, 1999).

¹⁴ The Postal Service states that Ms. Daniel “made an effort to address many of the concerns that were expressed about the McGrane study.” Tr. 10/4006 (Moeller). However, her changes occurred only in the allocations, not in the fundamental nature of the analysis.

Not only is the distribution key analysis not a comprehensive analysis of the effect of weight on costs, but it does not even make any effort to observe the effects of weight on costs. As she admits, her distribution key follows essentially the same approach as did witness McGrane in Docket No. R97-1¹⁵ and retains "almost all of the assumptions underlying the R97-1 version of the cost distribution."¹⁶ Indeed, witness Daniel made no attempt to generate new data, but merely modified the distribution methodologies in a few respects, including using a different allocation key for elemental load costs and a different treatment for mail processing tallies.¹⁷

The frustration continues. The Postal Service once again has offered the same basic allocation, differing only in its assumptions, rather than undertaking the effort to develop a more comprehensive cost data such as requested by the Commission or the Data Quality Study. The Commission should reject it once again.

¹⁵ Tr. 4/1403-1404 (Daniel).

¹⁶ Tr. 30/14698 (Tye).

¹⁷ Dr. Haldi, on behalf of Val-Pak/Carol Wright, submitted a detailed analysis of why "any study based largely on IOCS tallies is likely to be equally deficient." Tr. 32/15823-50. He notes Ms. Daniel's admission that IOCS data were "not specifically designed for the purpose of measuring the impact of weight on costs." Tr. 32/15824. He points out further that witnesses Moeller and Daniel both acknowledge that a properly-designed study should control for variations in factors such as dropshipping, presortation, and average haul. Tr. 32/15829-30 (Haldi). But, as he also points out, the Daniel data do not control for any of these factors. Tr. 32/15830; accord Tr. 24/11370-72 (Stralberg) (criticizing the Postal Service's continued reliance on IOCS data for costing purposes on grounds of statistical unreliability and its inability to explain why some costs are higher than others).

2. The Postal Service's distribution key analysis is unreliable

Like its predecessors, the Postal Service's distribution analysis in this case suffers from serious flaws due to the thinness and unreliability of the underlying data, as Dr. Tye, Dr. Haldi (VP/CW-T-1), and Dr. Clifton demonstrate. The allocation also fails to control for other factors that are correlated with weight. Tr. 4/1279 and 1285-86 (Daniel). That the distribution key is flawed is no surprise: the Data Quality Study concluded previously that "the existing cost and volume reporting systems do not provide reliable and complete estimates of mail volumes by weight."¹⁸

In Docket No. R97-1, the Commission criticized the Postal Service's cost analysis as based on too few tallies to be reliable: "The thinness of the tallies supporting the distribution of mail processing costs by weight increment represents a serious problem."¹⁹ That deficiency is repeated in this case.

The Data Quality Study observed that weight information is currently obtained from mail that is identified individually, which is less than half of all IOCS tallies.²⁰ All else comes from inferences. As Dr. Tye points out: "the number of tallies from which [the Daniel distribution key analysis] is derived are far too thin on which to base such a significant change in rate design."²¹ Tr. 30/14701 (footnotes omitted). This flaw

¹⁸ Data Quality Study Summary Report at 94.

¹⁹ R97-1 Op. at 400, ¶ 5419.

²⁰ Data Quality Study Summary Report at 93.

²¹ Witness Daniel's interrogatory responses show that the number of tallies on which her cost distribution relies is very low in many weight categories. For ECR mail, for example, only 16 mail processing and 11 city carrier in-office tallies were recorded in the 11-13 oz. range. Barely 100 tallies were recorded for city carriers in-office, and under 200 for mail processing, above 7 ounces." Tr. 4/1344 (direct tallies).

produces highly unlikely estimates, such as a conclusion that ECR letters weighing less than 3.5 ounces have lower unit costs than 3.5 nonprofit ECR flats. Tr. 4/1285 (Daniel). Anomalies exist within and across the cost data for subclasses. For instance, ECR parcels apparently cost only one-third as much as Nonprofit ECR parcels,²² while lighter nonprofit ECR parcels apparently cost more than four to seven times as much as their commercial counterparts.²³ Cf. Presiding Officer's Ruling No. R2000-1/45 (April 19, 2000) (noting that "[t]he small volume of Standard A ECR parcels makes it difficult to draw reliable conclusions about trends from its reported costs").

Interestingly, the number of IOCS tallies for ECR mail above 13 ounces was 115 -- a very small number but still larger than for many of the lighter weight ranges. Tr. 4/1408 (Daniel). This evidence supports a conclusion that heavier pieces do cause the Postal Service to incur substantial costs, and there is certainly no grounds for ignoring this evidence. Furthermore, Dr. Tye suggests a plausible explanation for why all four Standard (A) subclasses recorded more tallies at the highest weight increment than at lower levels. Tr. 30/14701-02.

²² See USPS-T-28 at 17, Table 3 (Daniel). Nonprofit ECR parcels average \$2.4946, ECR parcels average \$0.8242. Parcel shippers criticize this result as well. See Tr. 29/14140 (Zimmerman) (the USPS "cannot reconcile the absurd finding that a non-profit ECR parcel costs three times as much as a regular parcel to process. Manifestly, the smaller the sample size the less reliable and credible the data").

²³ See Daniel Testimony (USPS-T-28) at 17, Table 3. Nonprofit ECR parcels under 3.0 ounces cost \$4.4242 to send, while ECR parcels under 3.0 ounces cost only \$0.9441 (roughly one fourth). Nonprofit ECR parcels under 3.5 ounces average \$4.8351 to send, while similar weight ECR parcels average only \$0.6948 (roughly one seventh as much).

The rebuttal testimony of witnesses Prescott, Bozzo and Crowder do not and cannot cure these deficiencies.²⁴ The most important reason for their failure is that none of these witnesses offer any new data. Rather, they manipulate existing data in new ways. Therefore, they do not and cannot cure either the thinness of data or the fundamental design flaws of the analysis.

3. The distribution key analysis has been misused

Even if the Commission were inclined to use the Daniel distribution key allocation, the way that it has been misused throughout this proceeding should give the Commission considerable pause. The Postal Service has cherry-picked the distribution key allocation to support its proposals, but has ignored it when the distribution allocation leads to conclusions inconsistent with other parts of the Service's case. As such, it has been used as a drunk uses a lamppost—for support rather than illumination.

First, although witness Daniel herself testifies that she offers her data only as a "*general* indication of the effect weight has on total variable volume costs," USPS-T-28 at 3 (emphasis in original), the Postal Service relies upon it to propose a major rate restructuring of commercial ECR rates. This places far too great a burden on a mere cost distribution allocation whose essential design has been previously rejected by the Commission.

²⁴ Indeed, witness Crowder testified that no effort need be made because it would be too difficult. Tr. 32/19452. Although her rebuttal testimony presented some estimates of costs, they did not purport to reflect any institutional costs. Therefore, her comparisons of costs to rates omits an important ratemaking factor.

Second, Postal Service witness Moeller applies the distribution key allocation selectively and inconsistently among the Standard (A) commercial ECR and Regular subclasses (while not even purporting to apply it to the nonprofit subclasses). He also uses the Daniel analysis to support a contention that lowering the ECR pound rate would reduce an apparent disparity in cost coverage between piece-rated and pound-rated pieces. USPS-T-35 at 21.

However, as Dr. Tye points out, applying the same test to both Standard (A) Regular and First Class single piece mail (which no Postal Service witness does) yields results that are contrary to the Postal Service's rate proposals. Tr. 30/14707 (Tye). In particular, Dr. Tye points out that if the Postal Service truly believed that "equalizing these cost coverages" above and below the breakpoint were an important rate design consideration, then that consideration would require increasing the Standard (A) Regular pound rate, not the decrease Mr. Moeller proposes. Tr. 30/14708. The same test would also require a reduction in the First Class extra ounce rate, rather than the increase that the Service requests. Tr. 30/14709 (Tye).

Third, even with Ms. Daniel's distribution key analysis, the Postal Service does not apply a consistent standard for calculating the incremental effect of weight on cost for First Class and Standard (A) mail. Tr. 4/1416-19 (Daniel). This inconsistency is replicated in the rate design proposals of USPS witnesses Fronk and Moeller. In particular, when estimating the incremental cost of weight in First Class mail, Ms. Daniel excluded the cost of the first ounce of pieces. Tr. 4/1416 (Daniel). That is, she considered the cost effects beginning only with the second ounce. Witness Fronk, in

turn, who essentially uses a breakpoint of 1 ounce in First Class mail, also excluded the costs below one ounce in proposing to increase the extra ounce charge in First Class mail.²⁵ Tr. 30/14712 (Tye). This means that the rates for extra ounce First Class mail are set based only on the costs associated with the extra ounces of that mail, as the costs associated with the first ounce are recovered in the first ounce rate.

In contrast, in the case of Standard (A) ECR mail, witness Daniel included – at the request of Mr. Moeller -- the costs of *all* ounces (both above and below breakpoint) in presenting the weight-cost relationship in ECR mail. Tr. 4/1418-19. Unlike Mr. Fronk, who excluded the first ounce costs when setting the First Class extra ounce rate, Mr. Moeller used all of the costs of above-breakpoint mail when selecting a pound rate.

Thus, the Postal Service is setting the rates for heavier First Class and Standard (A) mail using inconsistent methodologies based on the same distributing key allocation. This is a tactic that the Commission should not accept.

4. The Postal Service is discriminating against First Class mail by raising its rates on the basis of the same distribution analysis used to justify a reduction in the Standard (A) ECR pound rate

Witnesses Moeller and Crowder both argue that the pound rate *must* be reduced because they have faith that “cost does not double with weight” – noting that currently the postal rate for an 8 ounce piece is 98% higher than that for a 4 ounce piece. This “belief” does not legally suffice to justify lowering the pound rate.

²⁵ Tr. 12/4874 (Fronk). Ms. Daniel admittedly provided the information requested by the rate design witnesses. “This type of analysis was not required by the First-class rate design witness.” Tr. 4/1323; see *also* Tr. 4/1168-69, 1416 (Daniel).

First, this "belief" depends for its factual support on the discredited Daniel distribution key allocation which, as shown above, does not provide adequate evidence of the effect of weight on costs. Put differently, one cannot know that costs do or do not double with weight unless one has a reliable measure of the effect of weight on costs to begin with. Absent reliable evidence of the effect of weight of cost, the assertion that "cost does not double with weight" has little substance.

Second, even if this were a well-founded proposition, the Postal Service would apply it in a grossly discriminatory manner violative of Section 403(c)(3). Witnesses Moeller and Crowder express no concern at all over the increases being sought for heavy First Class mail, where the same argument would apply with equal force, but the rates are already far higher. In First Class mail, the Postal Service proposes a 34 cent first ounce and a 23 cent extra ounce rate. Under these rates, a four ounce First Class piece would pay postage of \$1.03, while an eight-ounce piece would pay nearly double: \$1.95. In effect, the proposed new "pound rate" for First Class mail works out to \$3.79 (disregarding the Priority Mail rate of \$3.20). This high rate for heavy First Class mail greatly exceeds the 58.4 cent pound rate requested for Standard (A) ECR. If any group deserve relief, it is First Class mailers.

C. Comparisons to the prices of private firms are either inapt or misleading

Several parties have based arguments that the pound rate is "too low" on comparisons to rates charged by private sector alleged competitors. These comparisons are either incorrect or misleading.

Such comparisons are incorrect insofar as they purport to compare postage rates to prices charged by newspapers to advertisers. This is because, as the rebuttal testimony of NAA witness Wilson and the cross of USPS witness O'Hara clarify, newspaper insert rates do not compete with solo ECR mail.²⁶ Instead, newspaper prices are properly compared only to the prices charged by saturation mailers, such as Advo, for inclusion in shared mail packages. That is the market in which newspapers (and saturation mailers) compete.

Even where a comparison is made between alternate delivery charges and postage rates, the result is misleading. First, comparing the price for delivery by a government institution that offers six-day delivery by professional letter carriers and a nationwide routing and distribution system to a local, one-day delivery system using part-time workers is, at best, comparing greatly different things. This is particularly true where one is a \$65 billion institution of the federal government, backed by the Full Faith and Credit of the United States, and the other is a \$200 to \$300 million industry tottering on the brink of extinction. Val-Pak rebuttal witness Haldi's estimate that a nationwide stand alone private delivery company could be created with an investment of \$2.755 *billion* (Tr. 44/18862) does not pass the laugh test. Companies have tried it, and failed. Postal rates are simply too low for alternate delivery to thrive. If the pound rate is lowered, postal rates will be too low for alternate delivery even to exist.

²⁶ Although USPS rebuttal witness O'Hara sought to compare ECR rates to newspaper prices, he essentially conceded, on cross-examination, that his comparison was not proper. Indeed, rare is the advertiser that would choose between inclusion as a newspaper insert versus a standalone solo ECR mailing. Indeed, Dr. O'Hara, who imagined such an advertiser might exist, was unable to name a single one. Tr. 46E/21989. This is unsurprising because the two are simply not the same type of buy.

D. There is precious little evidence that reducing the ECR pound rate would lower advertisers' costs, rather than increasing mailers' profits

Although proponents of reducing the pound rate assert that doing so would improve the Postal Service's ability to compete for the delivery of advertising, there is precious little evidence that any advertiser would see even a penny of the reduction. This is because the Postal Service confuses the pound rate (which is a delivery cost for mailers) with the prices which newspapers and direct mailers such as Advo charge for the distribution of a single advertising piece. The two are different, and exist in different markets.

The single most telling moment for this issue in this entire proceeding occurred during the testimony of SMC witness Bradpiece. His prepared testimony stated that lowering the pound rate would "offset" an increased piece rate. When asked whether he would pass the pound rate reduction through to his customers through reduced preprint rates, he (in a moment of refreshing candor) admitted that the thought "hadn't occurred to me." Tr. 44/18963 (Bradpiece).

The testimony of SMC witness Guiliano, an officer of Advo, was much the same. It focused on how efforts to reduce Advo's costs of delivery contributed to the company's sixteenth consecutive quarter of record earnings. His testimony also asserts that Advo has saved millions of dollars from its token (and convenient) conversion to private delivery "all of which has gone directly to Advo's bottom line, substantially enhancing" its profitability. Tr. 44/19003. On cross-examination, Mr. Guiliano backed away from this claim, although he was unable to clarify the record. Indeed, there is

nary a word in his testimony about reducing the prices charged to advertisers. Indeed, Advo's prices appear nowhere in the record.

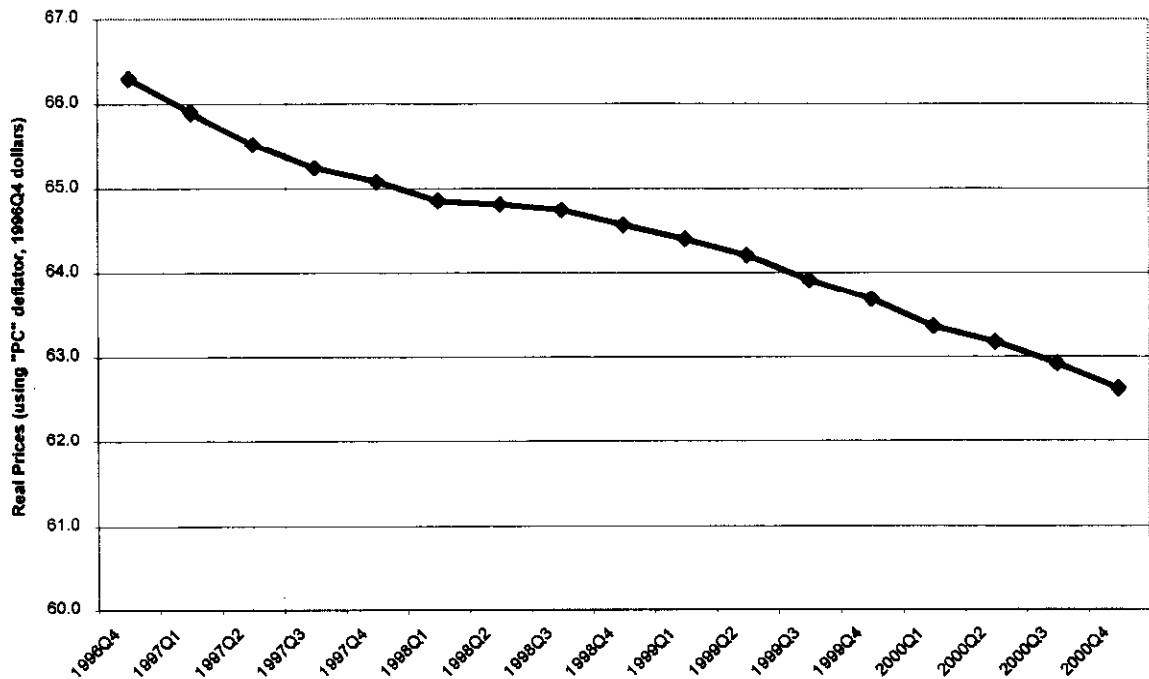
What saturation mailers do say is that lowering the pound rate would help them better compete—although they say little about how. They overlook the fact that, according to the most recent billing determinants, the mix of ECR mail has already shifted to a greater proportion of pound-rated pieces, suggesting that ECR mailers are not having trouble competing at heavier weight mailings.²⁷

E. The ECR Pound Rate Should Increase

The ECR pound rate has steadily declined in real terms since July 1996, while its nominal rate has remained unchanged as shown in Dr. Tye's testimony:

²⁷ A comparison of BY98 ECR piece- and pound-rated volumes (USPS-LR-I-166, wp1_comm) with those of the hybrid base year (USPS-LR-I-436, wp1_hybv) shows that while piece-rated volumes have fallen 9.47%, pound-rated volumes have increased 4.63%.

Real Pound Rate



Tr. 30/14740. Moreover, the pound rate that took effect in Docket No. MC95-1 itself was a reduction from the previous level. The Postal Service's own direct case implies that this reduction in the real pound rate relative to other media has increased ECR volumes by at least 10.84 percent since the inception of the subclass. Tr. 30/14742 (Tye).

Dr. Tye's testimony demonstrates that the Postal Service has failed to justify its proposal to reduce the pound rate. Nothing in the actual 1999 cost data justifies a different outcome. Indeed, the higher costs reported for Standard (A) ECR mail make any rate reduction -- much less one of the size proposed for the pound rate -- inappropriate.

Accordingly, as Dr. Tye points out in Section IV of his testimony, the pound rate should increase consistent with an across-the-board increase in ECR rates. Such an increase would also offset the actual decline in the real ECR pound rate in recent years.

III. THE COMMISSION SHOULD ACT DECISIVELY TO ALLEVIATE THE DISPROPORTIONATE INSTITUTIONAL COST BURDEN ON FIRST CLASS MAIL AND TO ENSURE THAT OTHER CLASSES PAY THEIR FAIR SHARE

Under the Postal Service's proposal, First Class mail will continue to pay a disproportionate share of the Postal Service's institutional costs, while Standard (A) ECR mail, in particular, would continue to make a disproportionately far smaller contribution. The Commission should not exacerbate this problem by accepting the Postal Service's proposal to reduce still further the Standard (A) ECR share of institutional costs. Instead, the Commission should retain the institutional cost contribution of ECR set in Docket No. R97-1, and build on its decision in Docket No. R97-1 to place greater reliance on comparisons of unit contributions. Increasing the ECR institutional cost contribution also will help avoid undesirable rate design anomalies within Standard (A) mail.

A. First Class Mail Continues To Pay An Excessive and Increasing Share of Institutional Costs

It is beyond dispute that First Class mail has consistently paid an excessive share of the institutional costs of the U.S. postal system. This is true whether measured by absolute dollars, cost coverage indices, or unit contributions. Correspondingly, commercial standard mail, particularly ECR mail, contributes less revenue and institutional cost contributions than is warranted by its proportion of volume or weight.

In recent rate cases, the Commission has repeatedly stated a desire to reduce this burden on First Class mail by moving its cost coverage closer to the system

average.²⁸ Yet extenuating circumstances in recent cases have impaired the Commission's ability to alleviate this burden to much extent. The relatively small increase proposed for Standard (A) ECR mail provides this Commission with an excellent opportunity to begin to correct this imbalance.

The disproportionate burden on First Class mail is, in fact, worsening. Dr. Clifton demonstrates that, since 1994, the cost coverages of First Class mail have increased compared to the cost coverage index or to the systemwide average, while those of Standard (A) Commercial Regular and ECR mail have decreased significantly. Tr. 26/12459 (Clifton). Even worse, OCA witness Callow demonstrates that the actual contributions of First Class mail in fact have actually exceeded the already burdensome levels recommended by the Commission. Mr. Callow shows that between FY 1988 and FY 1999, First Class mail has provided \$6.8 billion more than the Commission's recommended contributions.²⁹

In the three omnibus ratemakings since Docket No. R87-1, the Commission has repeatedly stated its preference to shift some of the disproportionate institutional cost burden borne by First Class mail to other classes, yet its ability to do so has been constrained by other factors.³⁰ With below average rate increases proposed for ECR

²⁸ See, e.g., *Opinion and Recommended Decision*, Docket No. R90-1 at IV-8, ¶ 4022 ("R90-1 Op."); see also *Opinion and Recommended Decision*, Docket No. R94-1 at IV-15, ¶ 4041 ("R94-1 Op.") ("setting target coverages [for First Class and third class mail] reasonably near the systemwide average represents the best accommodation of the section 3622(b) factors").

²⁹ Tr. 22/10120 (Callow).

³⁰ See *R90-1 Op.* at IV 33-34 n.16 ("This is the second consecutive case in which we might have raised First-Class rates less, and raised third-class rates more, but for
(Continued...)

mail, this case presents a perfect opportunity to rectify the inequitable imbalance in contributions of First Class and Standard (A) ECR mail.

B. The Commission Should Place Greater Emphasis on Unit Contributions as a Principal Measure of Institutional Cost Contributions, Particularly For Heavily Workshared Subclasses

In Docket No. R97-1, the Commission acknowledged the existence of "a flaw in the current Commission procedure for allocating institutional costs" arising from the use of percentage cost coverages to set institutional cost contributions for heavily-workshared subclasses.³¹ As the Commission recognized, and as explained by Dr. Tye in this case, high cost coverages for highly workshared subclasses are simply the direct and arithmetical consequence of basing rate discounts on avoided costs. The flaw identified by the Commission is that the Postal Service markup procedure results in subclasses with a relatively small amount of attributable costs from worksharing making less than equitable contributions to institutional costs.

To address this issue, the Commission committed to a more intensive review of its institutional cost allocation methodology to ensure "the adequacy of contributions from subclasses that heavily rely on functions which account for a large share of the

(...Continued)

the potential impact of such increases on third-class mailers. . . . [M]ailers should be aware that the current status is consistent with the Act only as a short-term remedy"); *R94-1 Op.* at IV-16, ¶¶ 4044-45, 4059 ("the other consequences of implementing [a lower First-Class rate] in this case would have included average rate increases of 17 percent for third-class regular rate, 24 percent for second-class regular rate, and even greater increases for the parcel subclasses in fourth-class mail" (citing rate shock concerns); *R97-1 Op.* at V-275, ¶ 5047 (raising First Class rates reluctantly to avoid "imposing undue rate increases on other classes of mail").

³¹ *R97-1 Op.* at IV-254, ¶ 4069.

institutional costs of the Postal Service.”³² The Commission stated that “[i]f a subclass is a relatively heavy user of one or more functions that engender significant amounts of [i]nstitutional costs, the Commission should assure itself that the unit contribution from that subclass is sufficient to recognize the value of those functions to users of the subclass.”³³ In particular, the Commission announced that it would place greater weight on unit cost contributions for heavily workshared subclasses.

Consistent with this new approach, as NAA witness Tye points out, unit contributions should serve as a larger factor in determining institutional costs for several reasons: “First, they highlight the actual contribution being made by the average piece. This can facilitate comparisons among similar subclasses. Second, unlike cost coverage percentages, unit contributions are not distorted by the differing degrees of worksharing among the various subclasses.”³⁴

This case illustrates the point well. The Postal Service's continued exclusive reliance on cost coverages allows it to ignore the gaping disparities in unit contributions between First Class and Standard (A) ECR mail. As Dr. Tye shows, First Class mail

³² *Id.* at IV-259, ¶ 4086.

³³ *R97-1 Op.* at IV-259, ¶ 4085.

³⁴ Tr. 30/14732 (Tye).

would make, under the Postal Service's proposal, twice the unit contribution as ECR mail even though both receive similar handling:

Comparison of Unit Contributions

	ECR	First Class
Using USPS Cost Methodology		
TY After-Rates Unit Contribution	8.19 ¢	17.85 ¢
Using PRC Cost Methodology		
TY After-Rates Unit Contribution	7.69 ¢	15.99 ¢

Source: Tr. 39/14731 (Tye) (based on BY 98 without adjustment for FY99 actual results).

As this comparison illustrates, whether using the Commission's or the Postal Service's cost methodology, the unit contribution for Standard (A) ECR mail is *less than half* of the unit contribution of either of the First Class letter subclasses. Moreover, the current Postal Service proposal would unduly *increase* the gulf between the unit contribution of ECR and First-Class mail. Under the Postal Service's proposal, using the Commission's methodology, the ECR unit contribution would rise by 0.14 cents. First-Class mail, however, would rise by nearly 10 times as much, by a whopping 1.32 cents.

Finally, the Commission should also bear in mind that the Postal Service's cost coverage estimate for ECR mail is overstated for two reasons. First, the Postal service's data regarding ECR cost coverage "fails to account for shifts in the distribution mail volume (the 'billing determinants') due to proposed changes in rate design (*i.e.*,

increased per-piece rates and reduced per-pound rates).³⁵ Second, the actual CRA data filed in July by the Postal Service shows that 1999 Standard (A) ECR costs exceeded the levels forecast by Postal Service witness Kashani in the original filing under both the Service's and Commission's methodologies. These higher actual costs suggest that Test Year ECR costs will be higher than originally forecast.³⁶

C. The Postal Service Proposes Such A Constrained Contribution For ECR Mail That It Is Forced To Create Undesirable Rate Design Anomalies Within ECR Mail

As Dr. Tye's testimony explains in detail, the Postal Service's institutional cost proposal for ECR mail directly results in rate design anomalies. Tr. 30/14718. These design flaws are entirely avoidable and arise from an apparent compartmentalization of the rate design and rate level functions and a misplaced concern that ECR rates are "too high." This concern about allegedly "too high" ECR rates stems in turn from a single-minded focus on percentage cost coverages to the virtual exclusion of actual per piece contributions. The proper solution is to correct the institutional cost contribution level so that these anomalies may be avoided. These corrections will also produce more rational rates consistent with the Act's dictate that the Commission consider the

³⁵ The Postal Service has recognized other shifts in the distribution of mail volume. For example, witness Moeller's revenue projections took into account that the residual shape surcharge (imposed in Docket No. R97-1) will cause a reduced volume of residual shape surcharge mail in the test year. See Moeller workpaper 1, pp. 13-14; see also Tr. 10/3894-96. Similarly, Postal Service witness Dr. Tolley calculated disaggregated volume changes for seven distinct rate categories for Standard (A) ECR mail. Dr. Haldi also agreed that the problem exists. Tr. 44/18868-70.

³⁶ Actual ECR costs in FY99 exceeded the original forecast by 4.6 percent. Notice of Inquiry No. 2 at Attachment 1, Page 1. When the actual FY99 are included in the TY forecast, the projected unit cost of ECR mail rises by 6 percent above the original

(Continued...)

"simplicity of structure" of the rate schedule and that rates have "simple, identifiable relationships." 39 U.S.C. § 3622(b)(7).

It is evident that neither the Postal Service's rate level witness nor its Standard (A) rate design witness considered the straightforward possibility of raising the ECR institutional cost contribution to give sufficient "headroom" to allow severe rate anomalies to be corrected. See Tr. 30/14720-23 (Tye). Ms. Mayes evidently did not consider it her responsibility to consider whether rate anomalies within and among subclasses could be solved by changes in institutional cost assignments. Nor, for his part, did Mr. Moeller profess to have any ability to influence the cost coverages given to the subclasses for which he designed rates. See Tr. 30/14721 (Tye). As noted in the following section, the record supports a reasonable solution.

D. The Postal Service Has Abandoned Its Only Objective Rationale For Reducing The ECR Contribution

The only objective basis for Ms Mayes' reducing the ECR cost contribution was an alleged change in the price elasticity of ECR mail. Tr. 11/4322 (Mayes). However, she later abandoned any contention that any significant change in ECR price elasticity has occurred since the last case. Accordingly, the record contains no objective support for reducing the institutional cost contribution of ECR mail.

As witness Thress explained, the alleged increase in the relative price inelasticity of ECR mail occurred because of a change in the demand equation specification, not in any change in ECR demand. Indeed, when witness Thress performed two sets of

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estimate (by witness Kashani) that used only 1998 actuals.

comparisons – one using the old data and the old specification, the other using the new data and new specification – both sets of results showed no significant difference. Tr. 30/14724 (Tye). In light of this, Ms. Mayes subsequently stated that she no longer believes that the purported difference in elasticity is statistically significant. See Tr. 30/14725 (Tye)(citing VP-CW/USPS-T32-16 (Mayes)).

E. This Case Presents The Commission With Specific, Workable Proposals To Alleviate The Institutional Cost Burden On First Class Mail

In his direct testimony, NAA witness Tye recommended³⁷ that the Commission: “adjust the existing set of ECR rates to the Test Year (incorporating 1999 actual costs in the process) so that:

- The real contribution per piece, after adjusting for attributable costs using the Commission’s approved methodology, equals or exceeds the unit contribution of commercial ECR mail at R97-1 levels and that the cost coverage or markup indices do not decline in absolute or relative terms; and
- Undiscounted piece-rated and pound-rated ECR mail receive common rate increases.”

Dr. Tye stated: “While I have not calculated Test Year attributable costs using the Commission’s methodology in light of the actual 1999 data, it would appear that setting rates pursuant to these principles would achieve the goals that I have identified.” Tr. 30/14744 (Tye).

The filing of actual 1999 cost data permits the calculation of proposed ECR rates that reflect these two principles. The revised unit cost for ECR (using FY1999 costs

³⁷

Tr. 30/14743-44 (Tye).

and the PRC methodology given by USPS-LR-I-442) is 8.506 cents (\$2.792 billion divided by 32.828 billion pieces).

The actual cost coverage recommended by the Commission in Docket No. R97-1 was 203%. Applying this Docket No. R97-1 cost coverage to the revised unit costs of 8.506 cents results in a unit revenue of 17.27 cents (8.506 cents x 203.0%). This constitutes a unit contribution of about 8.76 cents, which compares favorably with the 7.55 cents per ECR piece contribution that the Commission recommended in Docket No. R97-1.³⁸

If the Commission adopts a discount structure so that the total revenue impact of the discounts is unchanged from that proposed in USPS-LR-I-436, the undiscounted rate elements would need to be raised from current rates in order to achieve a unit revenue of 17.27 cents. Specifically, the basic nonletter piece rate would need to be raised from 16.2 cents to 18.6 cents, the basic pound rate would need to be raised from 66.3 cents to 76.0 cents, and the basic piece rate for pound-rated pieces would need to be raised from 2.5 cents to 2.9 cents.

NAA notes that the record also contains several other reasonable proposals that that would reduce the institutional cost burden on First Class mail. These include witness Callow's proposal to retain the 33 cent stamp Tr. 22/10134, 10145-46; *accord* Tr. 26/12343 (Bentley) and the proposals of Dr. Clifton and Mr. Bentley to reduce rates

³⁸ This exceeds the 7.552 cents per piece unit contribution of ECR mail in Docket No. R97-1, adjusted by witness Tayman's inflation factor of 4.8 percent. See DMA/USPS-T9 at 16 (Tayman).

for extra ounce or workshared First Class mail. NAA notes that if the Commission were to reduce the revenue requirement, First Class mail would be a worthy beneficiary.³⁹

IV. THE COMMISSION SHOULD APPLY ITS ESTABLISHED COSTING METHODOLOGY TO THE POSTAL SERVICE'S NEW CARRIER STREET TIME ENGINEERED STANDARDS DATABASE

In this case, USPS witness Raymond has presented a new database generated from his Engineered Standards ("ES") study for city carrier street activity, which provides a detailed and current breakdown of the activities engaged in by today's city carriers. See generally USPS-T-13 (Raymond). For the reasons detailed below, the Postal Service proposes -- quite correctly -- to use Mr. Raymond's ES database in lieu of the outdated 1986 Street Time Sampling ("STS") study upon which the Commission currently relies.

The ES study provides a database reflective of current carrier street activities upon which the Commission should apply its well-established attribution methodologies. In particular, the Commission should attribute city carrier access and coverage-related load time costs on the basis of the existing single subclass stop methodology. The Commission has consistently applied this methodology since Docket No. R87-1 as the soundest method for ensuring that all costs caused by a subclass are attributed to that subclass, and no compelling justification has been advanced in this case to warrant its replacement.

³⁹ Mr. Bentley (MMA-T-1) states that retaining the current 33 cent First Class single piece letter rate would cost about \$1.3 billion in revenue. This roughly approximates the reduction in the revenue requirement that would result from reducing the contingency allowance to one percent.

A. The ES Study

Since Docket No. R87-1, city carrier costs have been attributed on the basis of the STS survey. See *R97-1 Op.* at 156, ¶ 3226. As the Commission well knows, however, the activities of city carriers have changed materially since the STS survey was undertaken nearly fifteen years ago. Changes in the delivery environment include, *inter alia*, the increased use of cluster boxes and centralized delivery points, the replacement of many foot routes with motorized or partly motorized routes, increased delivery point coverage, increased volume per delivery, changes in mail mixtures, and the introduction and implementation of Delivery Point Sequencing ("DPS"). See USPS-T-12 at 36-37 (Baron); Tr. 39/17854-55 (Stevens).

NAA for some time has believed that the Postal Service's cost accounting systems systematically under-attribute city carrier load and access costs. Indicating that it also shares this concern, the Commission stated in the last omnibus rate proceeding that it would prefer a current, valid study to the STS survey. *R97-1 Op.* at 157, ¶ 3230. Similarly, the April 1999 Data Quality Study (a joint effort of the Postal Service, this Commission, and the General Accounting Office) recommended that operational data on carrier operations from the ES study be considered for use in the Postal Service's city carrier cost analyses. See A. T. Kearney Data Quality Study, Technical Report No. 4: Alternative Approaches For Data Collection (April 16, 1999) at 53-56.

Responsive to these requests, the Postal Service has submitted testimony by witness Raymond regarding the ES study. Because the ES study provides detailed,

comprehensive, and impartial observations describing what city carriers do in today's operating environment, it is clearly preferable to the outdated 1986 STS data.

1. Summary of the ES and STS Studies

The purpose of the ES study, which was conducted from October 1996 - April 1998, was to collect information regarding "*actual activities of the city letter carrier* and to develop engineered methods and time standards to establish a workload managing system." See *generally* USPS-T-13 at 5 (Raymond) (emphasis added). At six-minute intervals, independent ES data collectors recorded carrier activities using an electronic barcode scanning methodology. *Id.* at 6-7. Upon completion of the ES study, a thorough set of data containing over 39,000 separate observations of carrier activities was compiled. *Id.* at 14.

The ES study improves upon the STS study, introduced by USPS witness Hume in Docket No. R87-1 in order to develop time proportions for city carriers in postal rate cases. It was adopted by the Commission in that case and has been relied upon ever since to derive time proportions. The STS database relied on self-reporting by city carriers of their activities. These reports were subsequently used to develop time proportions. Witness Hume argued successfully in Docket No. R87-1 that the STS survey provided an updated, larger sample and successfully overcame many former data deficiencies. Tr. 39/17879 (Kent). The same rationale now mandates the replacement of the STS study with the more current ES study.

2. Comparison of the ES and STS Studies

While the underlying methodologies of the ES and STS studies are comparable, a comparison of the two studies shows that the ES database is superior to the STS database in a number of respects. As the following table from the rebuttal testimony of NAA witness Kent indicates, the ES database includes a larger sample size, a longer survey period, and a greater recording frequency.

Comparison of ES and STS Studies⁴⁰

	ES	STS
Survey Start Date	Oct-96	Jul-86
Survey Completion Date	Apr-98	Oct-86
Surveyed Months	15	3
Recording Frequency	Every 6 Minutes	3 Per Route
Recording Frequency /day	46	3
Tallies	39,046	7,103
Routes	340	2,400
Locations	53	91
Activity Combinations	1,350	20

The ES study's eighteen-month period provides a much longer survey period than the STS study and, unlike the STS study, it assures sufficient seasonal and monthly differentiation. Tr. 39/17881 (Kent). Furthermore, while the ES database contains more than 39,000 tallies, the STS study contains only 7,100 tallies.⁴¹

While the STS database contains more routes than the ES study, this factor is outweighed by the fact that the STS study is outdated, has a much smaller sample size,

⁴⁰ Tr. 39/17881 (Kent).

⁴¹ Tr. 39/17881-82 (Kent). This disparity grows even larger when one considers the 1,100 STS records that were dropped from the STS database because of "missed" or "no-call lunch" results. Ultimately, the STS study dropped 15% of the tallies, while the ES database dropped only 4% of the tallies due to personal, break or lunch observations. *Id.*

and is not as thorough as the ES study. Tr. 39/17882 (Kent). Moreover, in contrast to the STS study, the ES study's objectivity is assured by the fact that independent observers, as opposed to the carriers themselves, recorded carrier activity. Tr. 39/17850 (Stevens). It is thus clear that the ES study provides a more systematic, frequent, and objective review of city carrier activities than the STS study.

Finally, the ES study provides a much more detailed breakdown of current carrier activities than the STS study. The STS study limited a carrier to identifying whether he was moving between two, or stopped at one, of nine locations. Tr. 39/17884 (Kent). In contrast, the ES study provides a wide universe of 1,350 combinations to pinpoint precise carrier activities. *Id.* As the ES database represents a substantial improvement over the dated STS study, it should be adopted for use in this proceeding.

3. The ES Study is More than Sufficient for Ratemaking Purposes

Both the level of detail and the methodology of the ES study make it a much superior basis for ratemaking. In fact, as NAA witness Kent, whose firm frequently "manages data very similar to the ES data in ratemaking and rate reasonableness proceedings," observed, ". . . the work sampling data compiled by the ES study is more than sufficient for ratemaking purposes." Tr. 39/17887 (Kent).

While certain witnesses have questioned the efficacy of the ES study for ratemaking purposes, those concerns are misplaced. First, witness Crowder's allegation that work sampling was not a central focus of the overall ES study, Tr. 32/16152-61 (Crowder), is erroneous. As witness Raymond noted "the work sampling activity was the controlling activity for the data collectors, with all other activities subordinated to the objective of taking a work sampling tally every six minutes." Tr.

39/17907 (Raymond). Witness Raymond also effectively rebutted witness Crowder's allegations concerning overworked ES data collectors and insufficient training, noting that, *inter alia*, that:

- ES data collectors worked only three and one-half days per week;
- ES data collectors had no minimum number of time studies or other demands beyond taking work-sampling observations;
- there was more than adequate staffing for the project's workload;
- ES data collectors, especially in Phase 1, were not in need of extensive training because they participated in the design of the data collection methodology; and
- Given the logical nature of the barcode scanning methodology, little training was actually required.

Tr. 39/17908-11 (Raymond).

Second, witness Crowder's and witness Hay's general allegations that use of the ES database is not appropriate for postal costing purposes are equally misplaced. The purpose of the ES work sampling analysis is precisely the same as the STS study: to disaggregate carrier street time into activity categories. Tr. 39/17853 (Stevens). In fact, as Postal Service witness Stevens testified, "[t]he ES work-sampling database improves the quality of [Postal Service] costing by updating a critical part of the carrier analysis." *Id.*

Third, witness Crowder's assertion that the ES study overstates load time is unfounded. As Postal Service witness Stevens aptly points out, "I have visited carrier units all over the country. From my observations and discussions with local officials, there is no debate that load time has increased." Tr. 39/17854-55 (Stevens). Witness Stevens notes several factors contributing to the increase in load time today, including

an increase in assumed high load deliveries, the implementation of DPS, the decline in foot routes, and the growth in pieces of mail per stop. *Id.*

Fourth, witness Crowder's allegation that Mr. Raymond assigned a relatively small number of tallies to incorrect cost categories, particularly load, see Tr. 32/16186-91 (Crowder), is inconsequential. As Ms. Crowder noted in her cross-examination, the purported errors from misassigning activities are small in scope and effect. Tr. 32/16305 (Crowder). As even she has agreed, the number of allegedly misassigned tallies which she has been able to identify is less than one percent and Mr. Raymond challenges many of them. Response of witness Crowder to Questions Raised at the Hearing (July 27, 2000); Tr. 39/17917-19 (Raymond).

Finally, because of the studies' similar designs, witness Crowder's and witness Hay's criticisms of the ES study would seem to apply with at least equal force to the STS study. Tr. 39/17886 (Kent).

In sum, the number of tally observations, the recording frequency, and the recent completion of the sampling make the ES data superior to the STS data which the Commission has deemed sufficient for ratemaking purposes. Accordingly, the ES data should replace the outdated STS data in this proceeding.

B. The Commission Should Continue to Attribute City Carrier Access and Coverage-Related Load Time According to the Single Subclass Stop Methodology

Since Docket No. R87-1, the Commission has attributed city carrier access and coverage-related load costs on the basis of the single subclass stop methodology.⁴²

⁴² See *Opinion and Recommended Decision*, Docket No. R87-1 at 269; *Opinion* (Continued...)

This method recognizes that the access and coverage-related load costs incurred in delivering mail to a stop at which only one subclass of mail is delivered are indisputably caused by that subclass. The Postal Service acknowledges that these single subclass stop costs are, in fact, caused by the subclass delivered at the stop and admits that they are, in economic terms, incremental costs of the subclass.

Despite acknowledging this reality, the Postal Service (and some intervenors) have again sponsored testimony favoring a volume variability analysis of coverage-related load costs. However, no party has advanced a sound reason to depart from established attribution methodologies for either component of Cost Segment 7 costs.

1. Access Costs

The Commission has consistently attributed city carrier access costs on the basis of the single subclass stop methodology in every case since Docket No. R87-1 in which the necessary data were available. No party has seriously contested this approach for access costs in this proceeding. The single subclass stop ratios appear in this record in LR-I-151, which was sponsored by USPS witness Kay. Tr. 17/6704. The Commission should apply these ratios in the established manner to estimate Test Year attributable access costs.

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and Recommended Decision, Docket No. R90-1 at III-57; *Opinion and Recommended Decision*, Docket No. R90-1 On Remand at 55; *R94-1 Op.* at III-44; *R97-1 Op.* at 186. The Commission has done so mindful of its statutory obligation to "attribute to subclasses all costs that can be reliably associated with them, regardless of economic theory, primarily for reasons of inter-class equity." *R90-1 Op. (Remand)* at 41 (citing *National Association of Greeting Card Publishers v. United States Postal Service*, 462 U.S. 810, 828 (1983)); *see also R94-1 Op.* at III-41 to 42, ¶¶ 3136-42.

2. Coverage-Related Load Costs

Coverage-related load costs, on the other hand, have received substantial attention in this proceeding. USPS witness Baron has proposed a new volume variability analysis of coverage-related load costs, and MPA *et al.* witness Crowder has presented an alternative volume variability analysis. OCA witness Ewen, however, has recommended retention of the existing single subclass stop methodology. See *generally* Tr. 25/12023-43 (Ewen). The Commission should follow Mr. Ewen's recommendation.

NAA notes that Witness Baron's premise that coverage-related load time should be treated as an institutional cost was explicitly rejected by the Commission in Docket R97-1, *see R97-1 Op.* at 176-79, ¶¶ 3277-3279, and it should be rejected again. The problems with witness Baron's proposal are twofold: (a) it is an unnecessary "solution" to a nonexistent problem, and (b) it relies on unrealistic delineations of carrier activity.⁴³

NAA further notes that no party has challenged the fundamental precept that costs associated with the delivery of a single subclass of mail are caused by that subclass alone. Furthermore, as Mr. Ewen points out, the single subclass stop methodology is simple to apply and does not require speculation as to a carrier's activity during that portion of the delivery. Tr. 25/12034-36 (Ewen).

⁴³ Mr. Baron essentially replaces the Commission's definition of coverage-related load time as the residual of total accrued load time after the elemental component has been removed with his "stops effect" concept, which he defines as the "... increase in time that results from the accessing of a new stop." USPS-T-12 (Baron) at 7. Witness Baron regards this increment of time as a fixed component of time that is repeated at every stop and that is independent of the amount of mail delivered to a stop. *Id.*

Conversely, Mr. Baron's proposal that the Commission abandon its long-standing single subclass stop attribution methodology for coverage-related load time is difficult, if not impossible, to apply. Contrary to his testimony, there is no particular need to know exactly what a carrier is doing, particularly in a situation where the entire cost of an access is known to be charged to a single subclass. As Mr. Ewen correctly points out, "to determine the portion of [load] time that varies with volume, either directly or indirectly . . . it is unnecessary to separately identify and regard all of the actions occurring during the loading process as distinct." Tr. 25/12034 (Ewen).

Finally, the credibility of Mr. Baron's proposal is suspect because it remains in steady flux. Mr. Baron has offered no less than five versions of his approach in this proceeding, with the only constant being a continuing decline in volume variable costs.⁴⁴ In particular, in LR-I-310, witness Baron revised his original testimony (Baron I) by employing the ES data to estimate load time variabilities (Baron II). Subsequently, in his response to interrogatory UPS/USPS-T-12-16, witness Baron further revised his proposal (a) to correct an error in LR-I-310 (Baron III) in which he mistakenly included certain small parcels in the flats category and (b) to revise a regression equation to eliminate all volume interaction variables (Baron IV). Finally, in his rebuttal testimony, witness Baron's proposal was revised yet again (Baron V) to separate small and large parcels.⁴⁵ Because Mr. Baron's proposal(s) are unnecessary, unsettled, and unrealistic

⁴⁴ Postal Service rebuttal witness Kay confirmed that the net change in the estimate of out-of-office volume variable costs in Base Year 1998 has declined 23 percent since the case was filed, largely due to Mr. Baron's changes in methodology. See Tr. 39/17820 (Kay).

⁴⁵ Mr. Baron's multiple variations created labeling issues even for him. He labeled
(Continued...)

to administer, the Commission should continue to employ its single subclass stop methodology to attribute coverage-related load costs.

V. PERIODICALS RATES ISSUES

NAA agrees with the coalition of Periodicals mailers that the Postal Service's proposed rate increase for Periodicals mail is grossly excessive. While NAA does not agree with all of the specific recommendations of the Periodicals mailers, the Commission quite reasonably could moderate the Postal Service's proposed rate increase by recognizing the likelihood that certain cost reduction measures will prove successful in the Test Year. However, the Commission should not allow its desire to moderate the excessive proposed increase for Periodicals mail to cause it to abandon well-established principles of cost attribution.⁴⁶

However, Periodicals mailers have identified a number of Test Year cost savings that are reasonably likely to occur but that the Postal Service did not include in its TY forecasts. In particular, NAA recommends that the Commission adopt witness Cohen's proposals concerning bundle breakage (MPA, *et al*-ST at 2) and the AFSM 100 correction identified by witness Buc. See MPA, *et al*-ST at 3 (citing DMA-ST-1). In

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Baron III "Table 4A Revised Total" and his fourth version "Table 4B Final Revised Total." The latter was subsequently superseded by "Table 4D New Total" in his rebuttal testimony.

⁴⁶ For example, the changes in Mr. Baron's rebuttal testimony that reduce Periodicals costs by some \$203 million (see discussion at Tr. 43/18775 (Baron)) include an abandonment of the single subclass stop costing methodology for city carrier access and coverage-related load costs.

addition, the Commission should credit "ride-along" revenues to Periodicals mail so long as the associated costs are attributed to Periodicals as well.

VI. THE COMMISSION SHOULD ADHERE TO ITS WELL-ESTABLISHED PRECEDENT OF MEASURING INSTITUTIONAL COST CONTRIBUTIONS ON THE BASIS OF ALL ATTRIBUTABLE COSTS, NOT MERELY VOLUME VARIABLE COSTS

In the face of years of Commission precedent, the Postal Service proposes once again to assign institutional costs on a base of volume variable costs. This approach is contrary to the statute and Commission precedent,⁴⁷ and even conflicts with the Postal Service's own direct case.⁴⁸ The Commission has long construed Section 3622(b)(3) to require the basis for marking up institutional costs to be all attributable costs, not merely volume variable costs, and should continue to do so in this proceeding.

VII. CONCLUSION

For the foregoing reasons, the Newspaper Association of America respectfully urges the Postal Rate Commission to increase, not reduce, the pound rate for Standard

⁴⁷ The Commission has historically used, as the attributable cost basis upon which institutional cost contributions are based, the sum of volume variable cost and specific fixed costs. Tr. 31/15238-39 (Sappington). See *R90-1 Op.(Remand)* at 39 (quoting the Supreme Court in *National Association of Greeting Card Publishers v. USPS*, 462 U.S. 810 (1983) ("NAGCP IV")); *id.* at 43 ("The Court, therefore, has construed § 3622(b)(3) to obligate the Commission to attribute to subclasses all costs that can be reliably associated with them"); *R97-1 Op.* at IV-227; *Provisional Packaging Service*, Docket No. MC 97-5 Op. at 45; *Mailing Online Experiment*, Docket No. MC2000-2 Op. at 68.

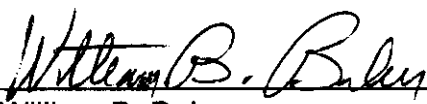
⁴⁸ See USPS-T-22 at iv (Bradley) (advocating that Commission "adopt incremental costs in place of attributable costs in its costing analysis" because "[i]ncremental cost is a more accurate measure of the total cost caused by a product and in the postal context incremental cost *will exceed attributable cost*").

(A) Enhanced Carrier Route mail, and to require Standard (A) Enhanced Carrier Route mail to pay a larger, more appropriate share of the institutional costs of the Postal Service commensurate with Standard (A) mail's increasing importance to the Service.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this date served the instant document on all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

September 13, 2000


William B. Baker